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Considerations For Employee Advisors Exploring Independence

Financial Advisory Industry Overview

The financial advisory industry continues to experience change bordering on chaos. Changes in the law, compliance, technology, and consumer preferences have fostered new business models and evolving service models. The financial advisory market has more segments today than ever.

The first segmentation is regulatory. Twenty-five years ago, financial advisory firms were primarily national firms and regional firms, with independent firms accounting for only a small percentage. The national and regional firms were historically licensed as broker-dealers, earning revenues through commissions on transactions. Independent firms were a mix of broker-dealers and registered investment advisors ("RIAs"). In 2000, there were approximately 7,000 broker-dealers, according to the SEC; in 2022, there were 3,378. Conversely, there were only 6,649 RIAs registered with the SEC in 2000, but over 15,000 in 2022.

The second segmentation is driven by the size and complexity of a firm's target clients, which require differing service models. The national and regional firms, the preponderance of which own or are owned by banks, have opted to leverage their extraordinary breadth of financial products. In those firms, the financial advisor is incentivized to maximize the firm's "share of wallet" with clients. The advisor does this by introducing product specialists in areas such as mortgages, alternative investments, insurance, trusts, lending, and cash management. This approach accomplishes two things that inure to the firm's benefit. First, the complexity of product and service offerings requires a team approach with distributed expertise. Second, it increases the importance of the firm in the client relationship, ameliorating to some extent the risk of advisor departures.

Meanwhile, the client service model in independent firms tends to be a high-touch, consultative model based on advice. The advice is centered around financial planning and investment management, but the key to this service model is client knowledge and communication. Among independent firms, there is also segmentation based on firm size. Charles Schwab publishes an annual benchmarking study based on surveys of its RIA client firms. Schwab defines the RIA market by organizational model and by size, as shown below.

Firm Organizational Models

Model	Definition	Assets Under Management	
		<$250MM	>$250MM
Solo	One advisor, possibly administrative support	27.2%	3.1%
Silo	Two or more advisors. Advisors paid for own revenues, share expenses.	12.6%	7.2%
Ensemble	Multiple advisors. Clients belong to firm. Relationship management orientation.	58.5%	74.5%
Enterprise	Large firm, multiple locations. Clients belong to firm. Well-defined functional teams. Layers of leadership.	1.7%	15.2%
		100%	100%

Source: Schwab 2020 RIA Benchmarking Study

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While the Schwab data is from RIAs, the organizational models apply to all independent firms, regardless of registration type.

The Schwab table captures the various organization models in independent firms of small size, but it does not address the very large independent firms characterized as "consolidators". While consolidation is very much a part of the financial advisory landscape, a few firms have executed a strategy of growth by acquisition with great success. All are backed by private equity firms, as shown in the table below.

Firm	2023 Acquisitions	AUM ($BB)	Private Equity Backer
CAPTRUST	9	$ 714.6	GTCR
Creative Planning	7	$ 155.3	General Atlantic
Hightower	6	$ 105.2	Thomas Lee
Wealth Enhancement Group	16	$ 56.4	TA Associates
Cerity Partners	7	$ 53.3	Genstar
Mercer Advisors	9	$ 35.1	Oak Hill, Genstar
Buckingham Strategic Wealth	6	$ 24.3	Clayton, Dubilier, Rice
Beacon Pointe Advisors	7	$ 23.2	KKR
Savant Wealth Management	6	$ 19.7	Kelso
Waverly Advisors	6	$ 7.9	Wealth Partners Capital
Merit Financial Advisors	8	$ 5.5	Wealth Partners Capital

"I Don't Know What I Don't Know"

Since the dawn of the industry, competition for financial advisors has been intense, and advisors have been generally attuned to opportunities with other firms. An employee advisor considering a move from one national or regional firm to another national does not face a daunting analysis. The decision will center on compensation, benefits, support, firm culture, and the all-important recruiting incentives. An employee advisor considering a move to an independent firm has a greater challenge.

Understanding such opportunities has never been more complex. As one advisor has said repeatedly, "I don't know what I don't know" as he considers offers and options available to him.

Regulatory segmentation is confusing. Advisors operate one way in broker-dealers where FINRA enforces a rules-based system and where "investor suitability" is the standard. Advisors operate differently in RIAs where they are required to act as fiduciaries.

Service model segmentation is confusing. Advisors play a quarterback role in national and regional firms, coordinating other players in a broad service offering, but they play a hands-on consulting role in a smaller firm.

Organization model segmentation is confusing. Which model will best support the advisor's client needs and provide the right balance of resources and independence?

These topics can be explored easily by advisors considering a move. There are a host of online resources dedicated to the topic. Word of mouth from other advisors who have experienced one segment or another is often the best source of answers to the questions surrounding a move.

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Making the Move

The greatest challenge in an advisor move is the transition of client assets. The terms of most agreements between financial advisors and their employers dictate that client account information and client assets are the property of the firm. Historically, when an advisor left one firm for another, the old firm filed litigation or sought cease and desist or temporary restraining orders to impede the advisor's ability to solicit his former clients. The basis of such legal action was usually an allegation that the advisor had improperly taken client information to the new firm. While the advisor was prohibited from activity by these legal maneuvers, the old firm unleashed other advisors on the departed advisor's clients to persuade them to remain there.

Because legal battles over financial advisors were expensive and often unsuccessful, Smith Barney (now Morgan Stanley), Merrill Lynch, and UBS came together to create in 2004 a "Protocol for Broker Recruiting". The Broker Protocol, as it came to be known, allowed advisors to take five bits of client information, including client name, physical address, email address, telephone numbers, and formal account title. The Broker Protocol only applies if the current firm and the new firm are both signatories to the agreement and if the advisor informs the current firm of his plan to resign.

While there are now many signatories to the Broker Protocol, two of the founding firms withdrew from the agreement in 2017, while others have added joinders qualifying their participation.

If one or both of the firms involved is not a signatory to the Protocol, the advisor must manage the departure very carefully and take no client information at all. Similarly, the advisor may not do a direct solicitation of his former clients, only a general solicitation, such as a newspaper or social media advertisement.

Whether the Protocol applies or not, any advisor considering a departure from one firm to another would be foolish not to seek the advice of legal counsel with specific experience in such matters.

In addition to good legal counsel, hiring a firm that facilitates advisor transitions can be very helpful. Such firms analyze the advisor's client base, including number and size of accounts, investment needs, and service needs, then recommends the best custodians. These firms also work with the advisor on client communication and transition paperwork.

Whatever the nature of an advisor's client base, whomever he hires to help with the transition process, it will take time to migrate clients to the new firm. A number of factors can affect timing. First, there is the nature of the client base; some clients are slow to sign documents, even electronically. Competition is a second factor. If the advisor's former firm incentivizes other advisors to retain whatever they can of the departed advisor's client base, that may further delay transition.

Industry averages indicate that 95% of the client base will eventually move, that may take several quarters, resulting in reduced advisor income in the meantime.

"Show Me the Money"

Any advisor considering a move likely has good reasons for it. Perhaps the current firm does not provide the best resources for the advisor's clients. Perhaps the advisor has not gotten an acceptable level of support. Perhaps the firm's culture is undesirable. Whatever the reason, money is always a factor in the final decision.

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Money is usually available to recruit advisors with attractive client books. Financial incentives may include forgivable loans, cash bonuses based upon meeting certain performance criteria, or equity incentives. Of these, upfront cash can be an important incentive, given the challenges of client transition.

Regardless of recruiting incentives, the advisor should be very clear as to the content of the firm's contract or advisor agreement.

Preparation

Abraham Lincoln said, "give me six hours to chop down a tree and I will spend the first four sharpening the axe." Before making any moves, a financial advisor must be measured and thoughtful in considering it.

Analyzing whether to leave one's current firm takes time. Once that decision to explore leaving is made, evaluating whether a given organizational structure would better meet the needs of one's clients takes time. Once the choice of organization structure is made, it takes time to find the best firms of that structure. Once the best firm is decided, one must seek the advice of counsel and of a transition firm, if desired.

After getting the advice of counsel and a transition firm, planning the departure and transition process takes time.

As if all this weren't complex enough, one must contact and begin the recruiting process with the chosen firm or firms.

The "four hours of sharpening the axe" will be well worthwhile.

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